BASEL III: "You're strangling us"

Community bankers object to complexity and heavy impact

By Steve Cocheo, executive editor and digital content manager

"Help! Small community banks are being strangled. How much more can we take?"

Perhaps the opening by Mark Munzer to his comment letter regarding the regulators' Basel III proposals of early June had a flair of the dramatic to it.

But Munzer, branch manager at The New Washington (Ind.) State Bank, $251.6 million-assets, was only expressing with verve a feeling enunciated over and over again among early comment letters that bankers have filed on the controversial proposals. Hundreds of comments have been filed thus far. Many solely asked the regulators to extend the comment date, which did happen. Comments are now due by Oct. 22.

But other letters reviewed express frustration with the Basel III proposals for their impact on community banks in general, while others very precisely attack specific provisions of the proposals. ABA has urged bankers to weigh in. (You can access ABA's Basel III page here. Resources include a members-only guide to assessing the impact on your institution.)

Concerns bankers cover include the impact of phasing out the grandfathering of trust preferred for banks that enjoyed that benefit under the Collins Amendment to the Dodd-Frank Act; the effect of substantially increasing the potential effect of risk-based standards on residential mortgage lending; the effects of changing the definition of Tier 1 capital to include AOCI--accumulated other comprehensive income; the detrimental effect of Basel III on Subchapter S banks' practices; and regulators' ignoring of the limited access that smaller banks have to capital markets, especially since the closure of trust-preferred pools. The list of concerns seems to grow as comments arrive.

Particularly forceful examples of overall comments:

- • "Capital is a terrible thing to waste," wrote Keith Halterman, president and CEO at Peoples Savings Bank, $143.2 million-assets, Indianola, Iowa. "The current Basel III proposals will waste a vast amount of capital and severely slow the current recovery we now have in our economy. ... under the current proposals we as community banks will be wasting away."

- • The proposed rules "are detrimental to the community banking model and their customers," wrote Bob Jones, president and CEO, United Bank, $460.7 million-assets, Atmore, Ala. "They directly inhibit profitability, increase the need for capital, and potentially restrict the availability of loans to individuals and smaller companies."

- • "We were not part of the irresponsibility that led to the financial meltdown and do not deserve to be harmed by the so-called solution," stated Ellen Louise Jett Mills, executive vice-president and BSA officer, Bank of the Bluegrass & Trust Co., $221 million-assets, Lexington, Ky.

- • "Our first observation is that complexity favors large banks," writes Guy Williams, president, Gulf Coast Bank & Trust Co., $904.6 million-assets, New Orleans. "Without intending to, this will continue the pressure on small banks. This cumulative pressure will cause further consolidation and encourage more small banks to exit the banking business."

Williams suggested leaving banks under $10 billion in assets under current rules. "This simpler approach would affect a large number of banks, but a relatively small percentage of banking assets--approximately 15%," Williams wrote.

- • "While the OCC is attempting to place capital back-stops in place to prevent another financial breakdown the unintended consequences of the additional burden on the community banks that played no part in it will further restrict the availability of credit to families and small businesses," wrote Todd Burton, executive vice-president and controller, Austin Bank, N.A., $1.3 billion-assets, Jacksonville, Texas.

Selected comments by topic

Comments can be read online as they are uploaded by the agencies. But here is a sampling of what is being said on some of the specific subjects mentioned:

- • AOCI: Wrote Harvey Schaan, president and CEO at First State Bank of Harvey, N.D.:

"My bank has consistently run with a very low loan-to-deposit ratio--35% to 45%. We therefore have a large portion of our assets in very secure government bonds. We rarely sell any of these bonds prior to maturity, but we have often seen AFS [available for sale] gains or losses of over a million dollars. While we are currently sitting with a large gain, this can easily turn into a loss when interest rates spike. Certainly we would be considered very safe by having such a large percentage of our assets in high quality government bonds, but any rapid increase in rates would cause our capital ratios to fall quite dramatically. A 2 to 3 percent rise in rates could very easily cause a $2 million drop in our capital and the bank would be the same bank and operate the same way both before and after the rate change. It does not make any sense to include the market loss in capital ratios when 99% of the bonds will be held to maturity and paid out in full."

- • Mortgage lending: One of the most common areas commented on.

Said Alabama' Bob Jones: "The risk weighting for 1-4 family residential mortgages with a balloon will increase to 100% from 35%, creating a significant increase in risk weighted assets. Community banks do not hold 30-year, fully amortizing loans, as the interest rate risk is significant, and they make balloon loans to both reduce risk and accommodate the needs of the customer. This is especially problematic in rural areas where homes often have difficulty qualifying for conforming mortgages. The increase in weighting has the potential of restricting the availability of credit to the community."

Wrote Clarence Zugelter, chairman, president, and CEO, First Federal Bank of Kansas City, Mo., regarding servicing portfolios:

"Each quarter we are required to calculate a current market value of the value of that servicing portfolio based on current interest rates and repayment assumptions. Under the Basel III proposal, once the value of our servicing portfolio would reach a certain percentage of our capital base, it would have to be deducted from our capital calculation. If we are currently calculating a market value on our servicing portfolio each quarter, I question why there should be a limitation placed on the amount of servicing values an institution could carry before it would impact their capital account."

- • Trust preferred: Many comments touched on this, but one of the most direct came from David Johnson, chairman, president, and CEO at

$108.4 million-assets Peoples Bank of Tulsa, Okla.:

"Thirty percent of my equity capital is tied to trust preferred securities. It is illogical and incomprehensible that the

government would arbitrarily decide to eliminate thirty percent of my equity capital over the next few years and call it good for the stability of our banking system!"

- • Commercial lending: Gary Yager, president of Topeka, Kan.'s Vision Bank, commented:

"In respect to the commercial loans that would increase to 150 basis points, risk rating banks will already increase the allowance for loan and lease losses to compensate for any future losses. So if banks have to risk rate at 150% it seems like we are being double charged, therefore again decreasing capital and limited the amount of new loans."

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